Elbit Systems Ltd.
Management's Report
For The Year Ended December 31, 2000

This report should be read together with the company's audited financial statement for December 31, 2001 and the accompany notes to the final statements.

A. The Company and its Business Environment

Elbit Systems Ltd. (the "Company") operates in the area of upgrading existing airborne, ground and naval defense platforms and is engaged in projects involving the design, development, manufacture, integration and marketing of integrated defense systems, electronic systems, electro-optic products and systems, software intensive programs and products for the defense and paramilitary sectors. In addition, the Company provides support and services for such platforms, products and systems.

The Company provides solutions for Western as well as former Eastern bloc equipment. It is engaged in the design, development, manufacture and integration of electronic and electro optic systems and products for various leading projects in Israel and worldwide, such as ground and naval command, control and communication ("C^3") systems, digital maps, night vision systems, pilot helmet mounted systems, display and data processing systems, unmanned air vehicles ("UAV's"), computerized simulators, communication systems, thermal imaging products, laser products, optical systems for space applications, airborne reconnaissance systems, optic communication products and systems, security products and systems, and electric drive systems. The Company often cooperates with industries in Israel, as well as in the countries of its other customers.

B. Reporting According to Generally Accepted Accounting Principles in the United States ("US GAAP")

Following an amendment to the Israeli Securities Law that became effective in August 2000, and following the required approval by the Company's shareholders and option holders on February 28 2001, commencing the fourth quarter of 2000 the Company adopted US GAAP as its accounting principles used for its financial statements , which were previously prepared under Israeli GAAP.

The financial statements of the Company for 1998 and 1999 and for the first three quarters of 2000, which were previously prepared in accordance with Israeli GAAP, have been readjusted for comparison purposes. (for reconciliation to Israeli GAAP see note 32 to the audited financial report).

Furthermore, together with the adoption of US GAAP, the Company also adopted the rules and regulations of the NASDAQ NM ("NASDAQ") as the basis for the Company's reporting to the Tel-Aviv Stock Exchange ("TASE"), the Israel Securities Authority and the Israeli companies Registrar.

C. Backlog of Orders

As of December 31, 2000, the Company's backlog of orders reached $1,437 million, of which 71% were for orders outside Israel. On December 31, 1999, the Company's backlog was $736.0 million, of which 70% were for orders outside Israel. The increase in backlog resulted mainly from the receipt of new orders, and the inclusion of the backlog of El-op Electro- Optics Industries Ltd. (" El-Op") and its subsidiary companies for the first time in the third quarter of 2000.

Approximately 72% of the Company's backlog as of December 31, 2000 is scheduled to be performed in 2001 and 2002.

D. Major Events During the Year

1. Merger with El-Op

On July 5, 2000, the Company completed its merger with El-Op, in which El-Op was merged into the Company in consideration for the issuance to the El-Op shareholders of 12,100,000 ordinary shares of the Company, with a market value of $180 million, subject to future adjustments in the event that material events would occur as specified in the merger agreement. The assets and liabilities of El-Op were merged into the Company, and in a vertical split certain assets and liabilities were transferred to a wholly owned subsidiary of the Company. The merger and the split were made in accordance with Israeli court approval. The merger was accounted for under the purchase method of accounting.

El-Op is a leading company in the field of advanced electro-optical products for defense, paramilitary and civil applications. El-Op's main business areas include development and production of thermal imaging products, laser products, optical systems for space applications, airborne reconnaissance systems, optical communications systems, fire control systems for combat vehicles and security products and systems.

On completion of the merger El-Op was reorganized as an Israeli subsidiary of the Company, and a majority of the companies that had been El-Op's subsidiaries until the merger became subsidiaries of the Company . Their operations have been integrated with the overall operations of the Company. The merger has been in effect since July 5, 2000 and accordingly, the financial results of El-Op and the companies which had been its subsidiaries until the merger are included in the Company's consolidated financial statements beginning with the third quarter of 2000.

For details related to the effect of the merger on the financial results of the Company, see "Results of Operation".

2. Major Subsidiaries and Affiliated Companies

The following are the Company's main subsidiaries and affiliated companies and partnerships whose results were included for the first time in the Company's reports in 2000, or in which the Company's percentage of ownership changed during the reported period.

- El-Op – wholly-owned Israeli subsidiary of the Company as described above.

- Companies in the United States that were held by El-Op prior to the merger have been merged with EFW Inc. ("EFW") – a wholly-owned subsidiary of the Company registered in the United States, and serving as the base for the group's activities in the United States, mainly in the area of development, production and maintenance of advanced defense products and systems.

- Ortek Ltd. ("Ortek") – 75% owned subsidiary registered in Israel, engaged mainly in the area of security products and systems and night vision equipment. (Prior to the merger Ortek was held by El-Op).

- Silver Arrow - Limited partnership registered in Israel, engaged in the business of UAV systems and products. Prior to the merger, Silver Arrow was owned 50% each by the Company and El-Op, and is now wholly owned by the Company, and a holding company Subsidiary of the Company.

- Semi-Conductor Devices ("SCD") – an Israeli partnership owned 50% each by the Company and Rafael Armaments Development Authority ("Rafael"), engaged in the development and production of semiconductor devices and lasers. (Prior to the merger the Company's share in SCD was held by El-Op).

- Opgal Optronic Industries Ltd. ("Opgal") – owned 50.1% by the Company and 49.9% by Rafael. Opgal is engaged mainly in the area of enhanced vision systems. (Prior to the merger the Company's share in Opgal was held by El-Op).

- Kinetics Ltd. ("Kinetics") - an Israeli company, 51% owned by the Company, involved in the development and production of systems for armored vehicles. Until the end of 1999, the Company held a 34% interest in Kinetics, and in the beginning of 2000 it exercised an option to acquire an additional 17% of Kinetics' shares.

- First and sub-tier holdings, in several high-technology start-up companies whose activities are mainly in areas based on technologies that were developed in the Company and its subsidiaries. The start-up Companies are involved mainly in the areas of optical communications, space and medical diagnostic equipment.

3. Additional Events in the Fourth Quarter of 2000

- CyOptics Inc. (Cyoptics"), a company held 32.5% (26.1% on a fully diluted basis) by SCD, raised $57 million in capital based on a valuation of $250 million pre-money through the issuance of shares on October 3, 2000, of which $4.8 million was invested by SCD. As a result, SCD's holding in CyOptics decreased to 27.2% (22.8% on a fully diluted basis), and SCD recorded a deferred gain of $10 million (the Company's share of which is $5 million). Under US GAAP the gain, net of taxes, is recorded as capital reserve. CyOptics is a development stage company in the field of optical communications.

- On December 28, 2000, EFW acquired the assets and the activities of Honeywell Inc., relating to the area of display and tracking systems for helicopter head mounted systems, for the amount of approximately $14 million.

E. Results of Operation

1. Special Events which Affected the Business Results

a. The Effect of the Merger on the Financial Results of The Company

As mentioned above, the merger was accounted for under the purchase method. The purchase amount of $180 million exceeded the book value of El-Op by $130 million. Of the excess, $21 million was attributed to the fair value of the identifiable tangible assets, net of $4 million in deferred taxes. The balance, in the amount of $109 million, was attributed to intangible assets, net of $14 million in deferred taxes.

In accordance with an appraisal performed by an independent appraiser, approximately $40 million of the purchase price was allocated to in-process research and development ("IPR&D") projects and was written off immediately at the time of the merger. This allocation represents the estimated fair value of incomplete research and development projects, which at the time of the merger had not yet reached technological feasibility, and where the research and development in progress had no alternative future uses.

The present value allocated to the projects was determined, among others, on the basis of the estimated discounted future net cash flows which would be generated from the projects if they reach commercial feasibility, based on their development stage as of the date of analysis.

The projects included in the analysis were mainly projects that were, at the merger date, in various stages of design, development, engineering and testing activities and were associated mainly with the following areas: thermal imaging (night vision); lasers; avionics; battlefield management; fire control systems; remote sensing; airborne and UAV reconnaissance; enhanced landing systems, and other classified projects.

The balance of the cost attributed to intangible assets was allocated as follows - $58 million to developed technology and know how, trade names and assembled workforce, net of $14 million in deferred taxes, and $25 million to goodwill. The amounts allocated to intangible assets will be amortized on a straight line basis over their 7 to 25 year estimated life. The weighted average period of amortization for the intangible assets was determined to be 17 years, and the amortization will be reflected in the cost of sales and in G&A expenses.

Restructuring Program

Following completion of the merger, the Company's management adopted in the third quarter of 2000 a program for organizational changes aimed at increasing the efficiency and maximizing the utilization of the resources at the Company's disposal, and the synergies resulting from the merger. As part of such program, the armored vehicle activities of the Company have been transferred to El-Op, the UAV activities of the Company and El-Op have been combined into Silver Arrow, and the U.S. operations have been re-organized under EFW.

In the third quarter of 2000 the Company commenced implementation of the reorganization and cost reduction plan. The plan includes, among other things, the consolidation of duplicate activities, adjustments in some of the Company's and its subsidiaries' fixed assets, employment terminations, write-off of duplicate inventories and equipment, and other related expenses. The total expense required for the plan was estimated by the Company to be $22.1 million (before tax). The Company had accrued $15.4 million for write-offs in inventory, machinery and equipment, and accrued $3.2 million for employment terminations and $3.5 million in respect of other restructuring related costs.

The Company continues its efforts to find ways to increase efficiencies and maximize synergies resulting from the merger. In case of future decisions involving charges or additional expenses, such expenses will be recorded when the decisions are made and the costs related to such decision can be estimated.

2. Summary of Financial Results

The following table sets forth the consolidated income statement of the Company and its subsidiaries for the periods listed. The consolidated financial results for the quarter and for the year ended December 31, 2000 include the results of the activities of El-Op starting in the third quarter of 2000, excluding write-off in the amount of $40 million and non-recurring charges due to the Company's restructuring program amounted to $22.1 million (before tax) and amortization expense of $1.4 million (before tax) per quarter, resulting from the amortization of excess of cost over book value resulting from the merger, starting in the third quarter of 2000.

	For the year ended December 31				For the three months ended December 31			
	2000		1999		2000		1999	
	$	%	$	%	$	%	$	%
	(In thousands of U.S. dollars except per share data)							
Total revenues	**591,084**	100.0	**436,030**	100.0	**211,759**	100.0	**115,472**	100.0
Cost of revenues (*)	**424,419**	71.8	**314,309**	72.1	**152,346**	71.9	**82,935**	71.8
Gross profit	**166,665**	28.2	**121,721**	27.9	**59,413**	28.1	**32,537**	28.2
Research and development expenses, net	**44,274**	7.5	**32,655**	7.5	**14,768**	7.0	**7,830**	6.8
Marketing and selling expenses	**45,110**	7.6	**34,049**	7.8	**16,862**	8.0	**9,643**	8.4
General and administrative expenses(*)	**25,185**	4.3	**15,482**	3.5	**8,642**	4.1	**4,793**	4.1
	114,569	19.4	**82,186**	18.8	**40,272**	19.1	**22,266**	19.3
Operating income	**52,096**	8.8	**39,535**	9.1	**19,141**	9.0	**10,271**	8.9
Finance income (expenses), net	**115**	0.0	**1,645**	0.3	**(983)**	(0.4)	**232**	0.2
Other income (expenses), net	**3**	0.0	**(164)**	(0.0)	**(21)**	(0.0)	**(225)**	(0.2)
Income before income taxes	**52,214**	8.8	**41,016**	9.4	**18,137**	8.6	**10,278**	8.9
Provision for income taxes	**12,061**	2.0	**9,743**	2.2	**4,361**	2.1	**2,202**	1.9
	40,153	6.8	**31,273**	7.2	**13,776**	6.5	**8,076**	7.0
Minority interest	**(217)**	0.0	**283**	0.1	**(504)**	0.2	**0**	0.0
Company's share of affiliated companies and partnerships gains (losses)	**(1,429)**	(0.3)	**(723)**	(0.2)	**413**	(0.2)	**638**	0.5
Net earnings excluding one time charges and amortization of excess of cost over book value	**38,507**	6.5	**30,833**	7.1	**13,685**	6.5	**8,714**	7.5
Amortization of excess of cost over book value related to the merger	**2,242**	(0.4)	**0**		**1,121**	(0.6)	**0**	
Net earnings excluding one time charges	**36,265**	6.1	**30,833**	7.1	**12,564**	5.9	**8,714**	7.5
Diluted earnings per share excluding one time charges and amortization of excess of cost over book value	**1.19**		**1.16**		**0.36**		**0.33**	
Diluted earnings per share excluding one time charges	**1.12**		**1.16**		**0.33**		**0.33**	
Weighted average number of shares used in computation	**32,247**		**26,488**		**38,276**		**26,445**	

(*) Excluding the amortization of the excess of the cost related to the merger amounted to $2.8 million before tax ($2.2 million after tax) in 2000, and $ 1.4 million ($1.1 million after tax) in the last quarter of 2000.

3. 2000 Compared to 1999

Revenues

The Company's revenues are segregated by lines of business and the geographic regions in which it operates.

Revenues increased from $436.0 million in 1999 to $591.1 million in 2000. The main reason for the change in revenues was the consolidation of the revenues of El-Op and the subsidiaries held by El-Op prior to the merger, starting in the third quarter of 2000.

The following is the revenue distribution by business lines:

	Year ended December 31, 2000	Year ended December 31, 1999
	(In $ millions)	
Airborne systems	257.8	262.9
Armored vehicles systems	111.8	67.0
C^3 systems	113.8	104.4
Electro-Optics	91.1	*
Other	16.6	1.7
	591.1	436.0

* not material

Following is the revenue distribution by geographical regions:

	Year ended December 31, 2000	Year ended December 31, 1999
Israel	27%	23%
United States	32%	27%
Europe	21%	39%
Other Countries	20%	11%

Gross Profit

Gross profit, excluding amortization of excess of cost related to El-Op of $1.7 million, was $166.7 million in 2000 as compared to $121.7 million in 1999. The gross profit margin in 2000 was 28.2% as compared to 27.9% in 1999.

The changes in the gross profit and the gross profit margin resulted mainly from the consolidation of El-Op and subsidiaries held by El-Op prior to the merger for the first time in the third quarter of 2000.

After the amortization of excess of cost related to the merger, gross profit in the year ended December 2000 was $165.0 million (27.9 % of revenues).

Research and Development

As a company whose main business is the development of advanced technologies, products and systems, the Company invests in research and development, in accordance with a long- term plan, based on estimated market needs.

Gross research and development expenses in 2000 totaled $53.3 million (9.0% of revenues), as compared to $39 million (8.9% of revenues) in 1999. Net research and development expenses (after deduction of the Government of Israel Chief Scientist participation) in 2000 totaled $44.3 million (7.5% of revenues), as compared to $32.7 million (7.5% of revenues) in 1999.

The Company's R&D expenses in the reported periods were in accordance with the Company's long-term plan. The increase in the R&D expense in 2000 was due mainly to the inclusion for the first time in the third quarter of 2000 of the expenses of El-Op and the subsidiaries held by El- Op prior to the merger.

Marketing and Selling Expenses

Marketing and selling expenses in 2000 were $45.1 million (7.6% of revenues) as compared to $34.0 million (7.8% of revenues) in 1999.

The change in the expenses was due mainly to the inclusion of the expenses of El-Op and the subsidiaries held by El- Op prior to the merger starting in the third quarter of 2000.

General and Administration Expenses

General and administrative expenses, excluding amortization of excess of cost in the amount of $1.1 million in 2000, were $25.2 million (4.3% of revenues), as compared to $15.5 million (3.5% of revenues) in 1999.

The changes in the G&A expenses in 2000 resulted mainly from the consolidation of El-Op and subsidiaries held by El-Op prior to the merger starting in the third quarter of 2000. The G&A expenses in 2000 also include expenses related to the merger with El-Op as well as expenses related to other merger and acquisition activities.

After including the amortization of the excess of the cost related to the merger, G&A expenses in 2000 were $26.3 million (4.4% of revenues).

Operating Income

As a result of all of the above, operating income (excluding one time charges and amortization of excess of cost related to the merger) totaled $52.1 million in 2000, as compared to $39.5 million in 1999. The operating profit margin decreased from 9.1% in 1999 to 8.8% in 2000.

After amortization of excess of cost, operating income in 2000 was $49.3 million (8.4 % of revenues).

After including restructuring expenses, the operating income in 2000 was $27.2 million.

Finance Income, net

Finance income, net, in 2000 was $0.1 million, as compared to $1.6 million in 1999.

The change in the finance income, net, was caused mainly by an increase in the Company's loans, principally as a result of the consolidation of El-Op and its subsidiary companies starting in the third quarter 2000, as well as by delays in receiving receipts under certain contracts, and by increases in investments in subsidiaries and fixed assets.

Income Before Tax

Income before tax in 2000 (before non-recurring items and amortization of excess of cost related to the El-Op merger) was $52.2 million (8.8% of revenues) as compared to $41.0 (9.4% of revenues) in the year ended December 31, 1999.

Taxes on Income

Provision for taxes for 2000 (before non-recurring item and amortization of excess of cost related to the merger) was $12.1 million (23.3% of income before tax) as compared to $9.7 million (23.6% of income before tax) in 1999.

Net Earnings and Earnings Per Share ("EPS")

Net earnings in 2000 (before non-recurring items and amortization of excess of cost related to the merger) was $38.5 million, as compared to $30.8 million in 1999. As percentage of revenues, net earnings decreased from 7.1% in 1999 to 6.5% in 2000.

Fully diluted EPS in 2000 (before non-recurring items and amortization of excess of cost related to the merger) was $1.19, as compared to $1.16 in 1999. The number of shares used for computation of fully diluted EPS in 2000 was 32,247 thousand shares (31,572 thousand shares used for calculation of basic EPS diluted by 675 thousand shares from options) as compared to 26,488 thousand shares in 1999. The increase in the number of shares was due mainly to share issuance made in connection with the merger.

Net earnings including amortization of excess of cost related to the merger (excluding non-recurring items) in 2000 was $36.3 million (6.1% of revenues) and fully diluted EPS (excluding non-recurring items) in 2000 was $1.12

Net loss for 2000 after non-recurring items and amortization of excess of cost related to the merger amounted to $ 20.5 million, and fully diluted net loss per share after non-recurring items and amortization of excess of cost related to the merger was $0.65.

4. Quarterly Data

2000 Results Divided by Quarters (in thousands of US dollars) (*)

	Q1	Q2	Q3	Q4	2000
Total revenues	107,014	105,551	166,760	211,759	591,084
Cost of revenues (*)	76,694	76,043	119,336	152,346	424,419
Gross profit	30,320	29,508	47,424	59,413	166,665
Research and development expenses, net	8,796	8,643	12,067	14,768	44,274
Selling and administrative expenses (*)	12,922	11,882	19,987	25,504	70,295
Operating income (*)	8,602	8,983	15,370	19,141	52,096
Finance income (expenses), net	1,013	881	(796)	(983)	115
Other income (expenses), net	169	120	(265)	(21)	3
Income before income taxes (*)	9,784	9,984	14,309	18,137	52,214
Provision for income taxes	2,058	2,297	3,345	4,361	12,061
Company's share of affiliated companies and partnerships gains (losses)	(223)	(85)	(1,534)	413	(1,429)
Net income (*)	7,737	7,666	9,419	13,685	38,507

*Excluding one- time charges and non-recurring expenses of IPR&D and restructuring expenses in the third quarter, and merger related amortization of excess of cost in the third and fourth quarter of 2000.

Fourth Quarter of 2000 Compared to Fourth Quarter of 1999

The Company's revenues and expenses in the fourth quarter of 2000 include the revenues and expenses of El-Op and its subsidiaries that were consolidated in the Company's results beginning with the third quarter of 2000.

Revenues in the quarter ended December 31, 2000 were $211.8 million, as compared to $115.5 million in the fourth quarter of 1999.

The revenues were distributed by business lines as follows:

	Three months ended December 31, 2000	Three months ended December 31, 1999
	(In $ millions)	
Airborne systems	81.1	61.0
Armored vehicles systems	26.8	19.5
C^3 systems	34.2	34.3
Electro-Optics	66.4	(*)
Other	3.3	0.7
	211.8	**115.5**

* not material

Gross profit in the three-month period ended December 31, 2000 (excluding amortization of excess of cost resulting from the merger with respect to intangible assets of $0.9 Million) was $59.4 million, as compared to $32.5 million in the three-month period ended December 31, 1999. After including the merger related amortization expenses gross profit was $58.6 million. The gross profit margin in the three months ended December 31, 2000 (excluding merger related amortization expenses) was 28.1% (27.7% after amortization) as compared to 28.2% in the three-month period ended December 31, 1999.

Gross research and development expenses in the three-month period ended December 31, 2000 totaled $17.3 million (8.2% of revenues), as compared with $9.3 million (8.1% of revenues) in the three-month period ended December 31, 1999. Net research and development expense (after deduction of the Government of Israel Chief Scientist participation) in the three month period ended December 31, 2000 totaled $14.8 million (7.0% of revenues), as compared with $7.8 million (6.8% of revenues) in the comparable period in 1999. The Company's R&D expenses in the reported periods were in accordance with the Company's long-term plan.

In the fourth quarter of 2000, marketing and selling expenses were $16.9 million (8.0% of revenues), as compared to $9.6 million (8.4% of revenues) in the comparable period in 1999.

General and administrative expenses in the fourth quarter of 2000 (excluding $0.5 million of expenses resulting from the amortization of intangible assets which were created in the merger) were $8.6 million, as compared to $4.8 million in the fourth quarter of 1999. As percentage of revenues G&A expenses decreased from 4.2% in the last quarter of 1999 to 4.1% in the last quarter of 2000. After amortization of excess of cost related to merger, G&A expenses in the last quarter of 2000 were $9.2 million (4.3% of revenues).

The Company had finance expense of $1.0 million in the fourth quarter of 2000, as compared to finance income of $0.2 million in the comparable period in 1999. The change in finance expense was caused mainly by an increase in long and short-term debt to finance investments and projects.

Provision for taxes in the fourth quarter of 2000 (excluding merger related amortization of excess of cost) was $4.3 million, as compared to $2.2 million in the comparable period last year. The effective tax rate in the fourth quarter of 2000 was 24.0%, as compared to 22.0% in the fourth quarter of 1999.

Net earnings in the fourth quarter of 2000 (excluding merger related amortization of excess of cost) were $13.7 million (6.5% of revenues), as compared to $8.7 million (7.5% of revenues) in the comparable period in 1999. Fully diluted EPS in the three-month period ended December 31, 2000 was $0.36, as compared to $0.33 in the three-month period ended December 31, 1999.

The number of shares which were used in the computation of fully diluted EPS in the three-month period ended December 31, 2000 was 38,276 thousand shares, as compared to 26,445 thousand shares in the three- month period ended December 31, 1999. The increase was due mainly to the issuance of shares in connection with the merger.

After amortization of excess of cost related to the merger, net earnings in the fourth quarter of 2000 was $12.6 million (5.9 % of revenues) and the fully diluted EPS was $0.33.

1999 Compared to 1998

Revenues

The Company's revenues are classified according to their line of business and their geographical locations

The Company's revenues increased in 1999 to $436.0 million from $414.7 million in 1998, an increase of 5.1%.

Revenues generated by each of the Company's lines of business in 1999 were as follows: $262.9 million in airborne systems, $67.0 million in armored vehicles systems, $104.4 million in C³ systems and $1.7 million in others (mostly manufacturing of commercial products).

Revenues generated by each of the Company's lines of business in 1998 were as follows: $268.5 million in airborne systems, $52.6 million in armored vehicles systems, $85.0 million in C^3 systems and $8.6 million in others (mostly manufacturing of commercial products).

The geographical breakdown of revenues in 1999 was as follows: Israel - 23%, United States - 27%, Europe - 39% and other countries - 11%. In 1998 sales were distributed as follows: Israel - 19%, United States - 26%, Europe - 47% and other countries - 8%.

Gross Profit

Gross profit in 1999 was $121.7 million, an increase of 6.1% as compared to 1998 when gross profit was $114.7 million. Gross profit margin increased as well, and was 27.9% of revenues in 1999 as compared to 27.7% of revenues in 1998.

Research and Development

As a company whose main business is the development of advanced technologies, products and, systems, the Company invests in research and development, in accordance with a long- term plan, based on estimated market needs.

Gross research and development expenses in 1999 totaled $39.0 million (8.9% of revenues), compared with $39.4 million (9.5% of revenues) in 1998.

Net research and development expenses (after deduction of the Israeli Government's Chief Scientist participation) in 1999 totaled $32.7 million (7.5% of revenues), compared with $31.6 million (7.7% of revenues) in 1998.

The Company's research and development expenses in 1999 were in accordance with its long-term business plan. The expense on research and development as percentage of revenues was effected by the additional activities in new subsidiaries in which the level of research and development was lower than in the Company.

Marketing and Selling Expense

With the increase in revenues in 1999 as compared to 1998, marketing and sales expenses in 1999 increased to $34.0 million from $31.5 million in 1998. Marketing and sales expenses as a percentage of revenues increased from 7.6% in 1998 to 7.8% in 1999.

General and Administration Expenses

General and administrative expenses increased from $13.3 million in 1998, to $15.5 million in 1999. As percentage of revenues, general and administrative expenses increased from 3.2% in 1998 to 3.6% in 1999.

Operating Income

As a result of the above, operating income increased from $38.2 million in 1998, to $39.5 million in 1999, an increase of 3.4%. The operating income margin was 9.1% of revenues in 1999, similar to 1998.

Finance Income, net

Net finance income in 1999 was $1.6 million (0.4% of revenues) as compared to net finance income of $0.4 million (0.1% of revenues) in 1998.

Income Before Tax

Income before taxes in 1999 was $41.0 million as compared to $38.4 million in 1998, an increase of 7.4%. The margin of income before tax increased as well, from 9.2% of revenues in 1998 to 9.4% in 1999.

Taxes on Income

Provision for taxes for 1999 was $9.7 million as compared to $9.3 million in 1998. The Company's tax rate decreased from 24.1% in 1998 to 23.8% in 1999.

Net Income and EPS

As a result of all the above, net income in 1999 increased by 10.8% as compared to 1998 and was $30.8 million as compared to $27.8 million in 1998. As a percentage of revenues, net income increased from 6.7% in 1998 to 7.1% in 1999.

On a fully diluted basis the Company's EPS in 1999 was $1.16 as compared to $1.04 in 1998, an increase of 11.5%.

The number of shares used for the calculation of fully diluted EPS in 1999 was 26,488 thousand shares as compared to 26,879 thousand shares in 1998. The decrease in the number of shares between 1998 and 1999 is mainly a result of the purchase of Company's shares by a subsidiary, expiration of options (Series 2), and redemption of convertible debentures, which was offset by exercise of employee stock options.

6. Liquidity and Capital Resources

The Company's cash flow is effected by the cumulative cash flow of its various projects in the reported periods. Projects' cash flows are effected by the timing of the receipt of advances and the collection of accounts receivable from customers, which relate to specific events during the project, while expenses are on-going.

The Company's policy is to invest its cash surplus primarily in interest bearing deposits, in accordance with its projected needs.

The resources available to the Company include mainly profits, non-cash expenses, collection of accounts receivable, advances from customers, and Government of Israel programs, such as the Chief Scientist and development grants. In addition, the Company has access to bank credit lines in Israel and abroad based on its capital, assets and activities. The Company also has the ability to raise funds through the offering of shares and debentures to the public from time to time.

The Company's cash flow in the reported periods was effected by the consolidation of El-Op for the first time in the third quarter of 2000.

The Company's net cash flows used for ongoing operations in 2000 was $14.4 million, resulting mainly from the increase in net inventories and accounts receivable.

Net cash flow used for investments activities in 2000 was $15.8 million which was used mainly for the acquisition of fixed assets and investments in companies, and was partially offset by proceeds from long-term deposits.

Net cash flow derived from financing activities in 2000 was $45.5 million, which was derived mainly from increases in short and long-term borrowing and was used primarily for payment of dividends and repayment of credit extended to the Company in connection with the acquisition of real estate assets.

7. **Primary Risk Factors**

The Company operates in a competitive environment, requiring unique solutions combined with competitive pricing. The Company adapts itself to market conditions by adjusting its business strategy accordingly.

As a result of the Company's involvement in large upgrade projects for major customers with considerable financial volume, its income is influenced by a number of such large projects and customers. In addition, as a prime contractor the Company is responsible for leading and integrating large, long-term projects which include work performed by subcontractors.

The Company is exposed to certain political and financial risks which it attempts to minimize by means of insurance, receipt of letters of credit and guarantees, planning and executing projects in accordance with the level of receipts, and by attributing an applicable share of the risks to subcontractors. The Company receives advances from customers and is required in some cases to issue performance and advance payment guarantees.

The Company is required to extend credit in certain cases, and attempts, when deemed appropriate by the Company, to cover the risks associated with such credits.

Since its functional currency is the U.S. Dollar, the Company has foreign currency risks from time to time resulting mainly from contracts, payments, assets and liabilities denominated in currencies other than the U.S. Dollar. The Company hedges against such risks, as it deems necessary.

The Company is dependent on governmental budgets. In recent years certain defense budgets have been reduced, and there may be a tendency to defer issuing new orders. The Company believes that its sales to various countries and its involvement in the defense electronics segment of defense budgets reduce such risks.

On December 31, 2000, the Company had exposure due to liabilities denominated in New Israeli Shekels ("NIS") of $29 million in excess of its NIS denominated assets. This exposure was largely eliminated soon after the beginning of 2001.

Most of the Company's assets and liabilities which are denominated in currencies other than the NIS and the US Dollar, was covered as of December 31, 2000 by financial instruments (mostly forwarded contracts). On December 31, 2000 the Company had contracts for the sale and purchase of such foreign currencies totaling $18.6 million. The results of financial derivative activities was not material.

8. Dividends

The Company has declared a final dividend for 2000 of $0.32 per share.

Forward looking statements with respect to the Company's business, financial condition and results of operations in this document are subject to risks and uncertainties that could cause actual results to differ materially from those contemplated in such forward looking statements, including, but not limited to, product demand, pricing, market acceptance, changing economic conditions, risks in product and technology development, the effect of the Company's accounting policies as well as certain other risk factors which are detailed from time to time in the Company's SEC filings.

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